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WM. R. STAGGERY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1924.

No. 527.

UNITED STATES, *Appellant*,

v.

HARRIET ROGERS FLANNERY

and

J. ROGERS FLANNERY,

Executors of Estate of

JAMES J. FLANNERY, Deceased, *Appellees.*

APPEAL FROM THE COURT OF CLAIMS.

BRIEF OF APPELLEES.

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Statement of the Case.

James J. Flannery purchased certain shares of stock prior to March 1, 1913, which on March 1, 1913, were worth $275 per share. He sold them in 1919 for $225

per share, thus producing a loss of $50 a share when measured by the March 1, 1913, value. There was, however, no loss when measured by original cost prior to March 1, 1913. He deducted in his income tax return for 1919 the loss measured by the March 1, 1913, value, which was then permitted by the regulations of the Bureau of Internal Revenue. Subsequently the Bureau changed its regulations so that no loss was recognized beyond the extent of the loss based on cost, and an additional tax was assessed against the estate of Flannery, who had died in the meantime. His executors paid the additional tax under protest, filed a claim for refund which was disallowed and brought this suit in the Court of Claims. A judgment was rendered in favor of the executors, from which the Government has appealed to this Court. The case presents the single question whether under the Revenue Act of 1918 a taxpayer in computing his net income can use the March 1, 1913, value as the basis of determining a loss in the case of property acquired prior to that date.

Argument.

The Revenue Act of 1918 Plainly Makes the March 1, 1913, Value the Basis for Calculating Losses Regardless of Original Cost.

The Revenue Act of 1918 was in force during the year 1919 and applied to the deductions which are the subject of this suit. Section 214 permits the taxpayer to deduct from gross income among other things:

"(5) LOSSES SUSTAINED DURING THE TAXABLE YEAR AND NOT COMPENSATED FOR BY INSURANCE OR OTHERWISE, IF INCURRED IN ANY TRANSACTION ENTERED INTO FOR PROFIT, THOUGH NOT CONNECTED WITH THE TRADE OR BUSINESS * * *"

Section 202 (a) defines the losses deductible under Section 214 and is plain and unambiguous:

"THAT FOR THE PURPOSE OF ASCERTAINING THE GAIN DERIVED OR LOSS SUSTAINED FROM THE SALE OR OTHER DISPOSITION OF PROPERTY, REAL, PERSONAL, OR MIXED, THE BASIS SHALL BE—

"(1) IN THE CASE OF PROPERTY ACQUIRED BEFORE MARCH 1, 1913, THE FAIR MARKET PRICE OR VALUE OF SUCH PROPERTY AS OF THAT DATE; AND

"(2) IN THE CASE OF PROPERTY ACQUIRED ON OR AFTER THAT DATE, THE COST THEREOF; OR THE INVENTORY VALUE, IF THE INVENTORY IS MADE IN ACCORDANCE WITH SECTION 203."

The position of the taxpayer is that the language of the Act just quoted is clear and does not need interpretation. Section 202 (a) defines the losses from the sale of property which are deductible under Section 214. Where property acquired before March 1, 1913, is sold Section 202 (a) provides that the *basis* for ascertaining the loss deductible under Section 214 shall be the fair market value of the property on March 1, 1913. The definition of the word "basis" contained in Webster's dictionary is: "1. The foundation of anything. * * * 5. The first or fundamental principle."

Thus in making the value of the property on March 1, 1913, the *basis* for ascertaining the loss, Congress can only have meant that that value was the foundation upon which the determination rested, the first and

fundamental principle. If, as the Government contends, the March 1, 1913, value simply limits the amount of the loss which must first be ascertained by comparison of the selling price with original cost, then the March 1, 1913, value is not the foundation of the loss, or the first and fundamental principle of the determination--in other words, it is not the *basis*. Such a conclusion is directly contrary to the plain and specific declaration of Congress.

The declaration of Congress contained in Section 202 (a) is clear that, while the original cost is to be the basis or foundation of the loss, in the case of sales of property acquired *after* March 1, 1913, it is not to be the basis or foundation of the loss from the sales of property acquired *before* March 1, 1913, but that in such cases the basis is to be the March 1, 1913, value. In Section 202 (a) Congress established three different bases for ascertaining losses sustained from the sales of three different classes of property.

> (a) As to *all* property acquired prior to March 1, 1913, the basis for ascertaining the loss shall be March 1, 1913, value;
>
> (b) As to uninventoried property acquired after March 1, 1913, the basis shall be cost.
>
> (c) As to inventoried property acquired after March 1, 1913, the basis shall be the inventory value;

The Solicitor General says Congress meant cost to be the basis as to both classes (a) and (b) In that case why did Congress divide the section into Clauses (1) and (2)? Why did not Congress provide simply in one clause that cost should be the basis in *all* cases, if, as the Government now contends, that was its intention?

Surely, no one can read these clauses and conclude from the language used that Congress intended them to mean what the Solicitor General now contends they mean. If they must be given the meaning contended for by the Government the reason must be found outside the language employed.

The Government's argument is based on general reasoning as to the nature of losses. As a conclusive argument it asserts that what it calls "paper losses" cannot be deducted. It is not clear what is meant by the term "paper losses" and certainly the loss claimed by the taxpayer in this case was a real loss. Neither is it true that "paper losses" could not be deducted if Congress permitted it. Congress can permit any deductions it pleases. If Congress in so many words provided for the deduction of paper losses, then they could be deducted. There is only one question in the case and that is, did Congress intend that losses of the character here in question should be deducted. That question must be determined by a study of the Act of Congress and not by general reasoning or by describing the losses as "paper losses."

The Revenue Act of 1924 throws an entertaining light on the confident assertion by the Solicitor General of the existence of a general principle condemning the deduction of "paper losses." By that Act Congress deliberately decided to allow the deduction of the kind of losses which the Solicitor General's brief calls "paper losses." This decision by Congress was made in the face of the controversy over the deductibility of such losses under the 1918 Act, and constituted a reversal of the position taken by Congress in the 1921 Act in which, as is pointed out below, Congress changed the law and refused to allow the deduction of such

losses. The 1924 Act not only permits the taxpayer to deduct just such a loss as Flannery deducted, but is even more liberal than the 1918 Act. The provision in the 1924 Act is as follows:

> "204 (11) (b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater." * * *

In the endeavor to give some explanation of Clause (1) of the 1918 Act the Solicitor General's brief suggests that it applies only after it has first been determined there has been a loss, looking at the transaction as a whole. Where the transaction as a whole did not produce a loss, so the reasoning runs, the clause does not apply. The argument is that first having ascertained there is a loss, then the deductible portion of *the* loss is ascertained by the application of Clause (1). This suggestion is not borne out by anything in the act and would produce some queer consequences as shown by the two illustrations following:

Case One. In 1905 X buys property for $100. Its March 1, 1913, value is $1,000. In 1919 he sells it for $100.

Case Two. In 1905 X buys property for $100. Its March 1, 1913, value is $1,000. In 1919 he sells it for $99.

In the first case, according to the Solicitor General's brief, there is no loss on the whole transaction and although there is a loss using the March 1, 1913, value as a basis, Clause (1) does not apply and no deduction is allowable.

The second case, of course, is just like the first except for the insignificant variation that the sale in 1919 is for $99 instead of $100, thereby producing a loss of $1 taking the transaction as a whole. And yet, according to the Solicitor General's theory, that would be enough to cause Clause (1) to apply, permitting a deduction of the difference between the March 1, 1913, value and the selling price of $99, in the case supposed a loss of $901.

To avoid this absurd conclusion the Solicitor General will have to claim that Clause (1) is to be construed as though it limited the deductible loss to cases where there is a loss on the whole transaction and had a further limitation that even then the March 1, 1913, value shall not apply where that is more than cost. But there is nothing in the act justifying that. Plainly Congress meant that March 1, 1913, value should be the basis in *some* cases. We say it is to be the basis in *all* cases where property was purchased prior to that date. The Solicitor General, if he rejects our contention, must say in what cases it is to be the basis. We understand him to say that the March 1, 1913, value is the *basis* whenever in the case of property purchased prior to that date there is a loss on the whole transaction. And if he does say that, then we reach the absurd consequences developed by the two illustrations above.

A Comparison with the Language of the Revenue Act of 1921 Confirms the Construction Placed by the Taxpayer on the Revenue Act of 1918.

Had it been intended in the Revenue Act of 1918 that the original cost of property acquired prior to

March 1, 1913, was to be material in determining a loss, it would have been very easy to say so. For purposes of comparison Section 202 of the Revenue Act of 1921 may be cited, which provides:

> "(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *
>
> "(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—
>
> "(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;
>
> "(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; * * *"

It will be noted that the Revenue Act of 1921 (which was *not* in force in or for the year 1919) provided primarily that the basis for ascertaining gain or loss should be *the same* whether the property was acquired prior to or after March 1, 1913, and that such basis should be cost. Only if a gain or loss was established as compared with the original cost did the value on March 1, 1913, have any application, and then such value might reduce but could not increase such gain or loss for purposes of taxation.

The Revenue Act of 1918, on the contrary, provided

just as clearly for *different* methods of determining loss in the case of property acquired before and in the case of property acquired after March 1, 1913. As to property acquired prior to March 1, 1913, the basis in all cases was to be value on March 1, 1913. As to property acquired after March 1, 1913 (except inventoried property), the basis was to be cost.

Under the construction contended for by the Government there would be no difference in the meaning of the loss provisions of the Revenue Acts of 1918 and 1921. If so, why was the language changed? As was said by the Court in United States v. Hammers, 221 U. S. 220, 226:

> "* * * a change in the provisions of an act usually indicates, or is intended to indicate, a change of purpose, to enlarge or restrict the provisions of the prior law."

The Allowance of a Loss Under the Revenue Act of 1918, Based on March 1, 1913, Value Is Consistent With the Continued Practice of the Bureau of Internal Revenue under the Prior Revenue Acts.

The Revenue Act of 1909, effective January 1, 1909, had placed a tax on all corporations measured by their incomes. Although practically an income tax on corporations prior to the Sixteenth Amendment, it had been sustained as an excise tax based on income. Flint v. Stone-Tracy Co., 220 U. S. 107.

The Sixteenth Amendment to the Federal Constitution under which the recent income tax laws have been passed took effect February 25, 1913. The revenue

acts thereunder are based on the assumption that March 1, 1913, was the effective date of the amendment.

The Revenue Act of 1913 taxed income for 1913 from March 1st to December 31st, and for calendar years thereafter. This act allowed deductions "for losses actually sustained during the year," but did not specifically indicate the basis of the loss.

The Revenue Act of 1916 provided as follows as to losses by individuals:

> "Sec. 5. * * * (a) * * * Fourth. * * * *Provided,* That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;"

Regulations 33 (Revised), Treasury Decision 2690 promulgated January 2, 1918, construing the Revenue Act of 1916, contained the following provisions:

> "Art. 147. In the case of the sale of assets—real, personal, or mixed—the loss will be the difference between the cost thereof, or the value as of March 1, 1913, if acquired before that date, and the price at which disposed of. * * * "

Treasury decision 2740 issued June 24, 1918, contained the following:

> "In order to determine *whether there has been gain or loss on a sale*, and the amount of the gain, if any, in general under all three acts [the Acts

of 1909, 1913 and 1916] an amount must be withdrawn from the gross proceeds sufficient to restore the cost of the property or the capital value that existed at the commencement of the period under consideration (either January 1, 1909, or March 1, 1913)." (Italics ours.)*

Thus when the Revenue Act of 1918 was enacted in February, 1919, the holding of the Commissioner of Internal Revenue was that the original cost of property acquired prior to March 1, 1913, was immaterial in the case of individuals and that losses were to be determined by deducting the sale price from the March 1, 1913, value.

The Contemporaneous Construction of the Revenue Act of 1918 by the Officials Charged with its Enforcement was that Losses Sustained by the Sale of Property Acquired Prior to March 1, 1913, should be Based on the March 1, 1913, Value.

After the approval of the Revenue Act of 1918 on February 24, 1919, Regulations 45 were promulgated by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury April 16, 1919 (Treasury Decision 2831), which provided:

"Article 1561. * * * For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is (a) its fair market price or value as of March 1, 1913, if acquired prior thereto, or (b), if acquired on or after that date, its cost or its approved inventory value. * * *"

*The reference to January 1, 1909, is applicable only to the case of corporations, which were first taxed on income under the Revenue Act of 1909, which, as has been stated, was sustained as an excise tax.

This regulation remained in effect during the years 1919 and 1920. During the time the regulation was in effect James J. Flannery sustained the loss involved in this suit and his executors filed the return for the year 1919. It was not until July 28, 1921, that by Treasury Decision 3206, Article 1561 of Regulations 45 was amended so as to deprive tax-payers of the right to take losses based on March 1, 1913, values.

The tax involved in this suit was assessed under this amendment to the regulations, retroactively applied.

It is submitted that the immediate and contemporaneous construction of the Revenue Act of 1918 by the officials charged with its enforcement is of far greater weight than a regulation promulgated more than two years after the passage of the act.

The Allowance of a Loss Based on March 1, 1913, Value in the Case of Property Acquired before that Date Accords with Other Provisions of the Revenue Act of 1918 and with Decisions of the United States Supreme Court as to Capital and Income.

The provisions of the Act which are before the Court in this case provide for deductions from income earned during the year to provide for losses of assets. But assets are wasted in other ways than by losses. And provision must be made for deductions on such accounts. For instance, provision is made in the Act for the waste caused by depreciation of buildings, machinery, etc., and by depletion of natural resources. If the argument of the Solicitor General in this case

is sound then the deductions from income to cover losses due to depreciation and depletion must be based on cost and not on March 1, 1913, value. But such is not the case.

Section 214 (a) 10, of the Revenue Act of 1918 provides that in the case of properties acquired prior to March 1, 1913, the fair market value of the property on that date shall be taken in lieu of cost in determining a reasonable allowance for depletion and depreciation of improvements in the case of mines, oil and gas wells, and other natural deposits and timber.

Regulations 45, Article 161, relating to depreciation, states:

> * * * "The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or *its value as of March 1, 1913, if acquired by the taxpayer before that date.* * * *"

These statutory provisions and Departmental regulations show a consistent recognition of the underlying theory that all property on hand as of March 1, 1913, was capital and that only acquisitions since that time constituted income. It follows that depreciation or depletion was measured in such a way that the capital on hand March 1, 1913, would be returned to the taxpayer, and deductions were allowed in such a way as to recognize that the capital on hand March 1, 1913, was what had been lost.

This same principle had been stated and applied by the United States Supreme Court in early cases, as follows:

> * * * "In order to determine whether there has been gain or loss, and the amount of gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration. * * *
>
> "When the act took effect, plaintiff's timber lands, with whatever value they then possessed, were a part of its capital assets, and subsequent change of form by conversion into money did not change the essence. * * *" (Doyle v. Mitchell Brothers Company, 247 U. S. 179, 185, 187.)

> * * * "Certainly the term 'income' has no broader meaning in the 1913 Act than in that of 1909 * * * and for the present purpose we assume there is no difference in its meaning as used in the two acts. This being so, we are bound to consider the accumulations that accrued to a corporation prior to January* 1, 1913, as being capital, not income, for the purposes of the act. And we perceive no adequate ground for a distinction, in this regard, between an accumulation of surplus earnings, and the *increment due to an appreciation in value of the assets of the taxpayer.*" (Southern Pacific Co. v. Lowe, 247 U. S. 330, 335.) (Italics ours.)

It is apparent from the foregoing that the provisions of the Revenue Act of 1918, that statutory loss is to be determined by the value of the property on March

*Apparently the court referred to January 1, 1913, instead of March 1, 1913, because in the particular case the accumulations were wholly prior to January 1, 1913. There was no apparent intention to make any date other than March 1, 1913, the controlling one.

1, 1913, even if that is in excess of cost, are consistent with the general theory of the revenue acts in respect to questions relating to capital and income, that the value of the property as of March 1, 1913, is to be considered as the taxpayer's investment therein.

The Enforcement of a Retroactive Regulation Should Be Avoided.

It should be particularly noted that when James J. Flannery sold the stock of the Flannery Bolt Company in October, 1919, under the then existing regulation it was perfectly clear that he had sustained a loss which could be deducted from his gross income in determining net income. As a matter of fact the same regulation was in effect when the executors made the return for the year 1919.

When James J. Flannery took the loss he had a right to think that he could sell his stock and deduct the loss from income. He and other taxpayers who may have taken such losses, which they expected to offset against gains from other stock that they sold, are in the position of being trapped by the change in the regulations. It is obvious that many taxpayers in the position of Mr. Flannery took other gains in 1919 which they thought would be offset by losses. By the retroactive change in the regulations their gains may be taxable but their losses not deductible. While we do not know whether or not this was the case with James J. Flannery, it should be pointed out as a strong possibility in the case of any taxpayer, and as a reason for not changing the regulations retroactively. The policy to be adopted toward retroactive changes in the

regulations is indicated by Section 1008 of the Act of 1924, which only permits retroactive changes immediately required by a decision of a court.

The return of the executors was correct when made, *according to the law and regulations then existing.* They made no error at all in the return. Why should an additional tax have been assessed?

The Amendment to Article 1561 of Regulations 45, Under which the Tax was Assessed, was Due to a Mistaken Interpretation of the Case of Goodrich v. Edwards, 255 U. S. 527.

The case of Goodrich v. Edwards, 255 U. S. 527, was decided by the Supreme Court of the United States March 28, 1921. The principal point involved in that case and in a group of cases decided the same day was that profits realized upon the sale of property constituted income and that so much of it as accrued after March 1, 1913, was taxable under the income tax laws of 1916 and 1917 and the Sixteenth Amendment. It had been contended by taxpayers that the total amount realized from the sale of property was capital as distinguished from income, being an increment in value of the property while owned and held, and therefore no part thereof could be taxable as income. This question which had for a long time been the subject of debate among persons interested in taxation was finally settled by the definite decision that such gains constituted income, in the four cases of Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509 (sale of stock held by a trustee); Eldorado Coal Co. v. Mager, 255 U. S. 522 (sale of its mine by mining company); Good-

rich v. Edwards, 255 U. S. 527 (sale of stock held as investment); and Walsh v. Brewster, 255 U. S. 536 (sale of bonds held as investment).

In the case of Goodrich vs. Edwards there was a second point: The plaintiff had acquired certain stock in 1912 at a cost of $291,600. On March 1, 1913, the value of this stock was $148,635.50. It was sold in 1916 for $269,346.25. Thus the price at which it was sold showed a loss on the transaction taken as a whole but a profit compared with the March 1, 1913, value. A tax had been collected on a gain measured by the difference between the March 1, 1913, value and the sale price.*

This case is an unsatisfactory one, in that the Solicitor General did not attempt to defend the action of the Bureau of Internal Revenue. He confessed error with respect to the assessment, stating that in his opinion the statute imposed a tax upon a sale of property only where there was a gain over the original price paid (255 U. S. 533, 534). There was therefore no argument on the effect of the March 1, 1913, value as determining gain.

This court in its opinion pointed out that the Revenue Act of 1916 taxed as income "gains * * * derived from * * * sales or dealings in property"; that the court in *Eisner v. Macomber*, 252 U. S. 189, 207, defined income as " 'the gain derived from capital, from labor, or from both combined' provided it be understood to include profit gained through a sale or conversion of capital assets;" and then concluded that no gain—

*Walsh v. Brewster is similar to Goodrich v. Edwards and is cited as authority for the Government's position. It is not discussed in this brief because the opinion simply refers to and follows Goodrich v. Edwards. What is said in this brief, therefore, as to Goodrich v. Edwards is equally applicable to Walsh v. Brewster.

and hence no taxable income—was realized upon this sale.

The court thus held that the phrase "gains derived from sales or dealings in property" in the Revenue Act of 1916 meant "profit gained through a sale or conversion of capital assets," which was the only kind of gain from such a transaction which the court had included in its definition of income taxable under the Sixteenth Amendment in *Eisner v. Macomber*. This construction of the phrase was acquiesced in by the Solicitor General. To have widened the scope of the phrase to include a sale where there was no *profit* would have raised a grave constitutional doubt as to whether such "gains" were income within the meaning of the Sixteenth Amendment as construed by the court. Indeed, the Solicitor General admitted this on page 59 of his brief in that case.

The case of Goodrich v. Edwards did not involve the deductibility of losses. The facts did not raise any such questions. Losses were not mentioned. The reasoning of the decision has no bearing whatever on the deductibility of losses.

Manifestly the right to tax income and the right to authorize deductions are governed by different principles. For while, under the Sixteenth Amendment, Congress cannot tax as "income" anything which the courts do not hold is "income," it may allow many deductions from gross income in determining net income which are wholly in the discretion of Congress—which may, indeed, be pure acts of grace on its part—so long as the statute applies with geographical uniformity throughout the United States. *Brushaber v. Union Pacific Ry. Co.*, 240 U. S. 1.

While it may be true that certain deductions from

gross income *must* be allowed, Congress may and did in the Revenue Act of 1918 allow many deductions from gross income in determining net taxable income which are *not* necessary or even proper in a determination of net income from an economic point of view. Thus individuals are allowed to deduct contributions to religious, charitable, scientific, or educational corporations, up to a specified extent (Sec. 214 (a) (11)), interest and taxes on personal as well as on business obligations and property (Sec. 214 (a) 2, 3), and losses even though "*not* connected with trade or business * * * if arising from fire * * * or other casualty" (Sec. 214 (a) 6). A personal exemption—which for practical purposes amounts to a deduction—is allowed; credits or exemptions are allowed for dependents. These are pure acts of grace on the part of Congress.

A similar act of grace is the provision in Section 213 (b) 8 that so much of the compensation received from the government by a person in the army or navy during the late war as does not exceed $3,500 need not be included in gross income.

Congress need not have permitted any of the deductions mentioned above. However, in its discretion it chose to do so. Similarly it chose to permit the taxpayer to take as a deduction losses based on March 1, 1913, value. It took away that privilege in the 1921 Act. It restored it in the 1924 Act. None of the considerations affecting deductions for losses which Congress may in its discretion permit has any bearing upon the question of what is included in the definition of income as that word is used in the Sixteenth Amendment. But it was this latter question which was under consideration in the Goodrich case. Neither the decision in that case nor the opinion throw any

light on the problem here presented which is whether or not Congress did intend to permit taxpayers to deduct losses based on the March 1, 1913, value.

The Court of Claims in deciding this case below dismissed the Government's argument based upon the Goodrich case without difficulty. The court said:

> "It is urged, however, that the cases of *Goodrich v. Edwards*, 255 U. S. 527, and *Walsh v. Brewster*, 255 U. S. 536, are decisive of the question. These cases deal with the question of 'gain' in the act of 1916. They do not discuss or decide whether a loss claimed and ascertained as in this case is a proper deduction in computing net income of the individual under the revenue act of 1918. That the right to tax income and the right to authorize deductions are governed by different considerations is manifest. Our conclusion is that the plaintiffs are entitled to recover." * * *

In the case of Ludington v. McCaughan, 1 Fed. (2d) 689, the Circuit Court of Appeals for the Third Circuit decided under the Revenue Act of 1918 that where property acquired prior to March 1, 1913, at a price less than the fair market value on that date is sold by a taxpayer a loss may be deducted based on the March 1, 1913, value. This opinion contains such a convincing statement of the law that we should like to quote it in full were it not for the limitation of space. The court discussed the Goodrich and Walsh cases and said:

> "While in the language of the statute in respect to a taxable gain derived from the sale of personal property there was manifestly a constitutional question, no such question can be found in its language in respect to a loss which the statute

authorizes the taxpayer to deduct in ascertaining taxable incomes. No mention of losses is made in the Sixteenth Amendment, and there is no constitutional limitation upon the power of Congress in respect to the allowance of losses. Congress may allow or disallow them at will and upon any basis. Taxable gain is a constitutional concept denoting income which the taxpayer has derived, while deductible loss is a creation of Congress, varying from time to time as Congress deals with it in different ways.

"Reading the decisions of the Supreme Court in the Goodrich and Walsh cases as interpretations of the law only with reference to taxable gains—the subject of deductible losses was not touched—and believing that Congress is free to make its own definition of deductible losses, it follows that in construing the provision with reference to 'loss sustained' here in question, there is no constitutional limitation to be enforced and no constitutional doubt to be avoided, and hence no reason for restricted construction or for any construction which fails to give the words of the statute their plain meaning and import. *United States* v. *Standard Brewery Co.*, 251 U. S. 210, 217; *MacKenzie* v. *Hare*, 239 U. S. 299, 308; *Caminetti* v. *United States*, 242 U. S. 470, 485; *Russell Motor Car Co.*, v. *United States*, 261 U. S. 514, 519.

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"Feeling that in this regard the power of Congress was not limited, we are constrained to construe the words 'loss sustained' in the section in question literally and to hold that they mean just what they say, even though, as in this instance, the loss sustained, ascertained in the manner prescribed by statute, is greater in figures than it is in money, and the effect of its deduction from gross income is to decrease net income below its actual level.

> "We are driven to this conclusion, startling as it may seem, because we cannot hold that Congress did not mean what it said, and also because the language of a statute being plain and its meaning clear, and the statute itself being within the constitutional authority of the law-making body which passed it, our sole function is to enforce the law according to its terms. *Lake Co.* v. *Rollins*, 130 U. S. 662, 670, 671; *Caminetti* v. *United States*, 242 U. S. 470, 485."

There is a decision of the United States District Court for the Northern District of California, which holds the same thing: Vance v. McLaughlin, which is not in the Federal Reporter but which can be found in Commerce Clearing House Unabridged Federal Income Tax Service 1924, Volume 2, page 1296.

It is, therefore, confidently asserted that the Goodrich case which arose under the 1916 Act and which concerned the question of what is included in the term "income" in the Sixteenth Amendment, has no bearing on the case at bar which arose under the 1918 Act and involves only an inquiry as to what deductions for losses Congress intended to permit.

If there is any Doubt as to the Interpretation of the Revenue Act of 1918, it Should be Resolved in Favor of the Taxpayer.

As to this it is sufficient to point to the long-established rule of construction:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their pro-

visions, by implication, beyond the clear import of the language used or to enlarge their operations as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen. United States *v.* Wigglesworth, 2 Story 369; American Net and Twine Company *v.* Worthington, 141 U. S. 468, 474; Benzinger *v.* United States, 192 U. S. 38, 55."

(Gould *v.* Gould, 245 U. S. 151.)

Conclusion.

It is respectfully submitted that under the provisions of the Revenue Act of 1918, according to the natural meaning of the words of the act, the long-established administrative practice under previous acts, the contemporaneous construction of the act by the Bureau of Internal Revenue after its passage, and consistently with the other provisions of the act and Supreme Court decisions, a taxpayer might deduct as a loss in the year 1919 the difference between the March 1, 1913, value of property acquired by him prior to that date and its sale price in 1919 in spite of the fact that such sale price was more than the original cost prior to March 1, 1913.

It is further submitted that there is nothing in the case of Goodrich *v.* Edwards, 255 U. S. 527, or in Walsh *v.* Brewster, 255 U. S. 536, inconsistent with this view, those cases involving the construction of a different statute and involving the question of gains which have constitutional considerations not applicable to losses.

It is therefore respectfully submitted that the judgment of the Court of Claims should be affirmed.

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Acts of 1917 and 1916.

(No provision as to ascertaining gain or loss on sale of property acquired on or after March 1, 1913.)

Sec. 2. (c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

Sec. 5. Fourth. (2) *Provided*, That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

Act of 1918.

SEC. 202. (a) THAT FOR THE PURPOSE OF ASCERTAINING THE GAIN DERIVED OR LOSS SUSTAINED FROM THE SALE OR OTHER DISPOSITION OF PROPERTY, REAL, PERSONAL, OR MIXED, THE BASIS SHALL BE—

(1) IN THE CASE OF PROPERTY ACQUIRED BEFORE MARCH 1, 1913, THE FAIR MARKET PRICE OR VALUE OF SUCH PROPERTY AS OF THAT DATE; AND

(2) IN THE CASE OF PROPERTY ACQUIRED ON OR AFTER THAT DATE, THE COST THEREOF; OR THE INVENTORY VALUE, IF THE INVENTORY IS MADE IN ACCORDANCE WITH SECTION 203.

Mr. Beck says no change intended.

Act of 1921.

Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *

(b) That basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

(2) If its fair market price or value as of March 1, 1913, is lower than such basis, the deductible loss is the excess of the fair market price or value as of March 1, 1913, over the amount realized therefor; and

(3) If the amount realized therefor is more than such basis but not more than its fair market price or value as of March 1, 1913, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income.

Act of 1924.

Sec. 204. (11). (b). The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (a) the cost of such property (or, in the case of such property as is described in paragraph (1), (4), or (5), of subdivision (a), the basis as therein provided), or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *